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RE: Standard Offer Service Fuel Adjustments, D.T.E. 00-66, 00-67, 00-70

Dear Counsel:

The Department of Telecommunications and Energy ("Department") has received requests from Fitchburg Gas & Electric Light Company ("Fitchburg"), from Massachusetts Electric Company and Nantucket Electric Company (jointly, "MECo"), and from Boston Edison Company, Cambridge Electric Light Company, and Commonwealth Electric Company (jointly, "NSTAR") (collectively, the "Companies") for authorization to increase their standard offer service[(1)] rates as a result of substantial increases in fuel costs, which have driven up the price of electric generation this year.[(2)]

The requested increases are designed to collect the costs that the Companies incur in purchasing electricity from merchant generators or suppliers to serve their standard offer service customers.

Over the past year, there have been steep and significant increases in the prices of natural gas and fuel oil -- fuels commonly used for generating electricity in New England. The price increases are some of the most dramatic witnessed since the 1973 OPEC oil shock. For example, imported crude oil prices during 1999 through 2000, to date, have increased by 150 percent and the price of natural gas delivered to Massachusetts electric utilities during 1999 through 2000, to date, has increased by 80 percent (see *Petroleum Monthly Marketing*, Energy Information Administration, Nov. 2000; *Natural Gas Monthly*, Energy Information Administration, Oct. 2000). These increases are driven by national and international forces beyond either the Department's or the Companies' control. It is important to note that the fuel price increases are neither related to nor caused by the restructuring of the electric industry in Massachusetts. Faced with increased costs, the Companies have requested authority to implement the standard offer service fuel adjustment ("SOSFA") provisions contained in their tariffs. The Companies are requesting an increase to their standard offer service rates, rather than increase the deferrals that result from the under-recovery of standard offer service costs.

The Department conducted a detailed review and investigation of the various filings to determine whether the proposed increases are consistent with the legislative mandates contained in the Restructuring Act. The Department also investigated whether the proposed increases are properly supported by the Companies.[3] Our investigation has confirmed that the Companies are under-collecting standard offer service costs, that the Companies have properly documented these costs, and the Companies are accruing deferrals at a significant and highly problematic rate. The results of this investigation preclude ignoring these substantial increases in fuel costs as recoverable expenses incident to serving consumers. The inescapable fact is that if rates do not presently recover costs incurred for power provided, then serious adverse financial consequences are risked. The central, pressing question is whether payment falls due now as the power is demanded and the costs are incurred, *or* whether payment is deferred to some distant date and paid then with interest.

We are faced with the difficult task of balancing the burden of allowing present cost recovery against the potentially greater harm of increasing deferrals to be recovered in the future. The Department is mindful of the effect these increases will have on ratepayers, particularly on low-income customers. In his comments, the Attorney General spoke to the painful effect of rate increases on consumers throughout the state, both residential consumers and the business community. He urges us to delay implementation of the SOSFA to further investigate the nature of these costs and efforts by the Companies to mitigate their effects.

However, we are also mindful of the concerns of a number of commenters, particularly those expressed by AIM and DOER, who urge the Department to immediately implement the SOSFA to stem the rising level of deferrals resulting from the under-collection of standard offer costs. AIM, which represents the interests of the business community in Massachusetts, and DOER recognize that any accumulation of additional deferrals that would result from a delayed implementation of the SOSFA will hurt consumers who ultimately end up paying costs with interest. Instead, AIM and DOER urge prompt implementation of the SOSFA to collect properly documented fuel costs, and also to undertake any further consideration of mechanisms to offset the effect of the increases separately. This approach suggested by AIM and DOER is sound and reasonable. It appropriately balances the detrimental impact of continued deferrals while also recognizing the need to explore any additional mechanisms to offset the requested increases.

To expand on a point just made, continuing to provide standard offer services at prices that do not recover substantial increases in the cost of fuel is unacceptable for several reasons. *First*, as AIM points out, costs that are not recovered from standard offer service customers now will be recovered, with interest, from *all* customers in the future, *regardless whether* the customer received standard offer service or not. A business or residential customer that leaves standard offer service for the competitive market will still be forced to pay deferred costs for a benefit that particular customer never received. It is not equitable for future customers to pay higher rates in order to allow today's standard offer service customers to pay prices that are significantly below cost. Equity aside, doing so would also be inconsistent with the Act's purpose of an orderly transition to a well-functioning market for electric power. To the greatest extent allowed by the Act, the Department must ensure that prices are set at levels that recover the costs incurred.

Second, there is grave financial risk in forcing large deferrals. Within a very few calendar quarters (unless natural gas and fuel oil costs dramatically abate), the total amount of costs deferred for future recovery could well grow to a level that would threaten the financial viability of the distribution companies. High levels of deferrals affect the

Companies' ability to borrow funds and, in turn, to maintain a safe and reliable distribution system. The

longer-term interests of electricity consumers and of the economic infrastructure of the Commonwealth would be ill-served by such a development. The Companies testified that the aggregate total of their standard offer service deferrals as of August 2000 is $214.8 million. Without an increase in the standard offer service rate, these deferrals are projected to climb to $685.3 million by the end of next year.[(4)] Compared to the net incomes of these Companies, the numbers are of significant concern.[(5)] The Restructuring Act was passed during an extended period of national and international energy price stability. That stability has recently been disturbed by the OPEC cartel and decreased production of natural gas. To ignore this change would be to undermine the orderly implementation of forward-looking legislation.

Third, continuing to price standard offer service significantly below costs artificially impedes the development of a truly robust competitive market and the ability of competitive suppliers to develop products at prices that would attract customers. Standard offer service is a transition mechanism that is intended to be phased out by March 2005. Artificially suppressing standard offer service's price would preclude effective competition for customers by competitive suppliers. Stunting the growth of the competitive suppliers' share of the power market patently would subvert, and could well defeat, the purposes of the Restructuring Act. If we did not allow this market to develop, the promise of electric restructuring would remain unrealized. Consumers would be ill-served in the long run. The Department must make every effort to ensure that customer choice is a valid option for all as soon as possible.

For these reasons, we must allow the Companies to immediately implement the SOSFA. As discussed in greater detail below, allowing the Companies to collect properly supported fuel costs is consistent with the mandates of the Restructuring Act. Importantly, the Companies will not profit in any way from these increased fuel costs. They merely recover the increased costs of providing service. Furthermore, future decreases in the price of fuel oil and natural gas will automatically translate into adjustment or elimination of the SOSFA surcharge. If fuel-input costs go down, so too will the recoveries allowed today, in accordance with the restructuring settlements and plans.

The Attorney General, AIM, and others have helpfully suggested that the Department should investigate ways to lessen the net effect of these increases on consumers. We agree. As an initial matter, we should note that the Companies have already been required to fully mitigate transition costs as a prerequisite to stranded cost recovery. General Laws c. 164,

§ 1G(c)(3) and (4) require the Department to "explore any and all possible mechanisms and options" for mitigation only if a company is unable to meet the mandated rate reductions of the Restructuring Act. The Department finds below that the Act's rate reduction requirements should be viewed as being exclusive of substantial changes in the cost of fuel. Therefore, even with the SOSFA, the Companies are still able to meet the mandated rate reductions of the Act. Accordingly, no further investigation of mitigation efforts is *required* before the SOSFA may be implemented. *But* that is not to say that further investigation of mitigation efforts is not desirable. The Department is committed to exploring every possible mechanism and option to minimize the effects of these increases on both business and residential consumers. We view transition cost mitigation as an ongoing obligation of the Companies.

As detailed in the sections below, we will require all distribution companies to submit a report to the Department discussing all past, present, and future mitigation efforts that have been or may be undertaken to ease burdens on ratepayers. After review of these reports, the Department can better determine what further actions might be appropriate. There also are several programs available now to lessen the effect of rate increases on consumers this winter. The Department has amended its regulations to ensure that an even greater number of

low-income consumers will be protected from termination of their utility service during the winter heating season.[(6)] Residential discount rates and other programs, such as the Good Neighbor Energy Fund, are also available to assist qualified low-income consumers. The Department will continue to work with the Companies on outreach efforts to ensure that the greatest number of eligible customers receive this necessary assistance. Finally, to reduce electricity consumption, we direct the Companies to encourage all consumers to take full advantage of the residential energy efficiency programs offered by the Companies. The Companies should also work with the Department's Consumer Division to expand their budget billing and consumer payment plans during the winter heating season.

I. Standard Offer Fuel Service Adjustment

A. Summary of Proposals

The Companies propose to increase the price for standard offer service by implementing a uniform cents per kilowatt-hour ("KWH") surcharge on their standard offer service rates. While the Companies' tariffs contain an identical SOSFA, each company proposes a different method to implement the SOSFA provision. NSTAR calculates its proposed SOSFA surcharge using the most recent available historic fuel price data (NSTAR Filing at App. F). NSTAR proposes to reduce its SOSFA surcharge by 15 percent before adding it to its current standard offer service rates (id. at 5). Also, NSTAR proposes to adjust its standard offer service rates monthly for the SOSFA surcharge as long as the fuel-trigger point[(7)] is exceeded (id. at 6).

Alternatively, MECo and Fitchburg propose to add their total SOSFA surcharge to their current standard offer service rates (MECo Filing at PTZ, p. 11; Fitchburg Filing at 2). In other words, they propose an adjustment to the inflation-adjusted standard offer service rates. MECo determined its proposed SOSFA surcharge by calculating the average fuel adjustment for October 1, 2000 through December 31, 2000, using forecast fuel prices (MECo Filing at PTZ, p. 11). MECo proposes to fix the SOSFA surcharge through the end of 2000 (id.). Fitchburg, like NSTAR, proposes to adjust its standard offer service rate monthly using historic data for the SOSFA surcharge as long as the fuel trigger point is exceeded (Fitchburg Filing at 2). In addition, Fitchburg proposes to include a surcharge to collect, over a six or twelve-month period, an under-recovery resulting from the operation of its fuel adjustment since April 2000, the month it first exceeded its fuel trigger point (IR DTE-AG-1

(D.T.E. 00-66)).

B. Comments

The Companies argue that recovery of fuel costs is consistent with Department precedent. Specifically, the Companies argue that their respective restructuring settlement agreements, restructuring plans, and tariffs guarantee recovery of payments to wholesale standard offer service suppliers for fuel index-related costs (Tr. at 19, 22, 53; NSTAR Initial Comments at 2-3; MECo Reply Comments at 4; Fitchburg Reply Comments at 2). NSTAR and MECo also argue that their respective restructuring settlement agreements were found by the Department to be in substantial compliance with the Restructuring Act (Tr. at 22, 39; NSTAR Initial Comments at 3; MECo Reply Comments at 2). Fitchburg argues that its proposal is consistent with its standard offer service tariff, its Department-approved restructuring plan, and its Department-approved wholesale standard offer service supply contract (Tr. at 53; Fitchburg Reply Comments at 2). The Companies further argue that approval of their proposals will bring the price of standard offer service closer to the actual cost of providing the service and will reduce future deferrals, and so save customers carrying costs on deferred balances (Tr. at 20, 41, 56). Also, the Companies argue that approving the proposed adjustments will allow markets to develop more effectively (Tr. at 22; MECo Filing at PTZ, p. 12-13). Finally, the Companies argue that failing to allow their proposals would present them with serious financial concerns due to the continually increasing amount of deferrals (Tr. at 20, 41, 56).

While agreeing that the Companies may recover properly documented increases in fuel costs, the Attorney General urges the Department to reject the Companies' request for an immediate implementation of the SOSFA (Tr. at 12; Attorney General Initial Comments at 7, n.6). The Attorney General argues that with the pass-through of such fuel cost increases, the Companies will no longer be able to meet the rate reduction standard mandated by the Restructuring Act (Attorney General Initial Comments at 1). Before approving any rate increases, the Attorney General argues that the Department must investigate all possible mechanisms, including use of the Ratepayer Parity Trust fund, to mitigate the bill impacts resulting from fuel price increases (Tr. at 8; Attorney General Initial Comments at 8). The Attorney General also requests that the Department initiate a generic investigation to verify fuel costs and determine a single uniform mechanism to implement the SOSFA (Tr. at 9; Attorney General Initial Comments at 8). Finally, as a means to cushion the impact of any rate increase, the Attorney General argues that the Companies should continue to make levelized billing options available to customers as well as exercise flexibility when negotiating consumer payment plans (Attorney General Initial Comments at 7-8).

The Attorney General's position, opposing any implementation of the SOSFA until further Department investigation, is substantially shared by other commenters, including several organizations representing low-income customers, such as the City of Cambridge ("Cambridge"), the Massachusetts Public Interest Research Group ("MASSPIRG"), the Massachusetts Energy Consumers Alliance ("Mass Energy") and Greenworks (see

Tr. at 136-141, 154-156; Low-Income Customer Group[8] Initial Comments at 1-2; MASSPIRG November 20, 2000 Comments at 1l; Cambridge Initial Comments at 2). In addition, the Low-Income Customers Group opposes the rate increase, arguing that it improperly shifts all of the risks of a wholesale marketplace on consumers and fails to maintain the statutory requirement of discounted rates for low-income customers comparable to the low-income discount rate in effect prior to restructuring (Low-Income Customer Group Initial Comments at 1-2, citing G.L. c. 164, § 1F(4)(i)). Cambridge urges the Department not to pass on the effects of fuel-price increases until the competitive market is more fully developed (Cambridge Initial Comments at 1-2). Mass Energy and Cambridge also express concern that any allowed price increase should be temporary (Tr. at 145; Cambridge Initial Comments at 1).

Unlike the Attorney General, AIM argues that the SOSFA costs should be collected, subject to verification, as soon as possible in order to prevent any further deferrals (Tr. at 131; AIM Initial Comments at 2; AIM Reply Comments at 1). While AIM agrees that there should be further investigation to determine if measures have been taken to mitigate the impact on rates, AIM argues that such an investigation should be undertaken in a separate proceeding so as not to delay the implementation of the SOSFA (Tr. at 133; AIM Initial Comments at 3-6; AIM Reply Comments at 2). AIM argues that when implementing the SOSFA, it should be treated separately from inflation to maintain the economic value of the 15 percent rate reduction (AIM Initial Comments at 5; AIM Reply Comments at 3). Finally, AIM argues that the Companies should provide a six-month fixed standard offer service rate because monthly changes in the rate could cause customer confusion, prevent customers from effectively budgeting energy costs, and erect a barrier for customers trying to enter the competitive market (AIM Initial Comments at 6-7).

In addition, DOER urges the Department to implement the SOSFA immediately to reduce deferrals (DOER Reply Comments at 2). Like AIM, DOER supports the further investigation of ways to mitigate the Companies' generation-related costs, but only after an immediate implementation of the SOSFA (id.). In implementing the increases, DOER argues that the SOSFA surcharge should not be included as part of, but instead be treated separately from, inflation (DOER Initial Comments at 3-5). DOER argues that before restructuring, customers would have incurred higher electricity prices due to increased fuel prices through an increases in the fuel charge administered under G.L. c. 164, § 94G (id. at 5). For this reason, DOER argues that implementation of the SOSFA maintains the rate reductions required by the Restructuring Act (id.). DOER also supports keeping the standard offer service rate constant for a six or twelve-month period, arguing that monthly price changes have the potential to cause customer confusion and dissatisfaction in a period where rates are temporarily high and the competitive market has not yet been able to respond adequately (id. at 5-6).

Several competitive suppliers[9] also support an immediate implementation of the SOSFA to promote competition and avoid additional deferrals, thereby reducing the amount of carrying costs charged to ratepayers (Competitive Retail Suppliers Initial Comments at 1; Competitive Retail Suppliers Reply Comments at 1). Southern Energy also supports an investigation of the Companies' mitigation efforts, but in a separate proceeding so as not to delay the implementation of the SOSFA (Southern Energy Reply Comments at 3-4).

The competitive suppliers generally support a levelized payment plan option for residential and small commercial customers, if it is limited to no more than twelve months (Competitive Retail Supplier Reply Comments at 1). These suppliers argue that large customers have the ability to assess market conditions, already have more competitive options available to them, and, therefore, do not need the protection of a levelized payment plan (id.).

Finally, the Competitive Power Coalition ("CPC"), an organization representing a large number of generators and wholesale marketers of power in New England, also supports an immediate implementation of the SOSFA (Tr. at 74-78). CPC argues that an adjustment of standard offer rates to reflect a rise in fuel costs sends proper price signals, which will help jump-start the retail market by allowing new competitors to enter the market and encouraging consumers to pursue these competitive options (id. at 90).

C. Discussion

The SOSFA was established as long ago as 1997, and reaffirmed in 1998 and 1999, as an essential part of the Companies' restructuring plans or settlements[(10)] and of their existing standard offer service tariffs.[(11)] All of these were approved by the Department as consistent or as substantially compliant, with the Restructuring Act, G.L. c. 164, § 1A(a). In fact, the early restructuring settlements for MECo and Boston Edison Company, which each included a SOSFA, served as models of the art of the practicable during the 1997 deliberations on the Restructuring Act. MECo's and Boston Edison Company's plans were proposed for Department approval by settling parties, including the Companies themselves, DOER and the Attorney General. The other Companies' plans followed these models to an adjudicated decision. In these later cases, no objection was raised to the SOSFAs, and no appeal was taken from their approval by the Department. The actions taken today merely put into operation provisions that were already approved but remained latent during the period of fuel oil and natural gas price stability. We note that the SOSFA is not a new proposal by the Companies, but one that was contemplated as part of electric restructuring to ensure that substantial increases in the prices of fuel oil and natural gas did not have a negative impact on the development of competition. The SOSFA mechanism is designed so that when the price of fuel oil and natural gas exceeds the projected levels that served as the basis for the prices for standard offer service, an increase in the price of standard offer service occurs.[(12)]

Most of the Companies' standard offer service supply contracts also contain fuel index adjustment provisions that are identical to the SOSFA. These contract provisions allow the power supplier to increase the price charged for the power it supplies to the Companies only if the price of natural gas and fuel oil increases significantly. The price of the power supplied under most of these contracts first exceeded the fuel trigger point in April of this year. Up to then, fuel oil and natural gas prices had either been stable or had not risen for enough months to "pull" the fuel trigger in the supply contracts (see n.12, above). As a result, since April, the Companies' standard offer service revenues have been significantly less than their standard offer service costs. These under-recoveries are placed in a deferral account to be recovered from customers at a future date, with interest.[(13)] In the period before the Act, such fuel costs would have been recovered routinely under the fuel adjustment clause established by G.L.

c. 164, § 94G.

While any rate increase is unwelcome, we believe the most appropriate course at this time is to institute all actions to provide consumers the least cost over the long term while ensuring equity among all consumers. To accomplish this, it is necessary to stop the accumulation of rapidly growing deferrals with an immediate implementation of the SOSFA to increase the standard offer service rate.[(14)] Equity requires us to ensure that customers on whose behalf costs are incurred are the same customers who bear those costs.

Several commenters expressed concern that only properly verifiable fuel costs be passed on to consumers through the SOSFA. As described above, most of the Companies' standard offer supply contracts contain a fuel index adjustment provision identical to the SOSFA. In addition, other supply contracts contain similar fuel escalator clauses also permitting the supplier to pass-on increased fuel costs to the Companies.[(15)] A significant portion of the Companies' standard offer service loads is served under contracts allowing suppliers to pass on increased fuel costs. As such, the Companies have incurred significant increases in the costs to serve standard offer service customers. It is important to remember that standard offer service is a fully-reconciling cost, and the Companies make no profit in providing this service.

As part of their annual reconciliation filings, the Companies must submit a full accounting of their costs and revenues for standard offer service. The Department investigates the Companies' accounting in an adjudicatory proceeding. *Regardless of the way in which the various supply contracts collect increased fuel costs, all of the costs and revenues, including those collected under the SOSFA provision, are ultimately reconciled to ensure that the Companies collect only standard offer service procurement costs that are actually incurred.* So, in addition to the Department's current examination of the Companies' filings, the Department will continue to review and reconcile all costs annually.

Questions have been raised about whether the SOSFA adjustment is consistent with the Act's requirement that standard offer service customers receive a 15 percent reduction from inflation-adjusted, August 1997 rates. NSTAR's proposal answers these questions by treating the SOSFA as an additional component of inflation, while MECo and Fitchburg respond to these questions by treating the SOSFA as an extraordinary expense to be added as a surcharge to the standard offer service rates.

The Department has always treated fuel costs differently than other costs in setting rates for electricity. That is because the nature of those costs is fundamentally different from the nature of other costs. The cost of fuel can and often does vary significantly over short periods of time, whereas costs for labor, capital, and other inputs to the production of electricity generally change gradually over long periods of time, if at all. That is why the cost of fuel has traditionally been passed on to customers through a quarterly fuel charge, whereas changes to base rate costs are passed on to customers only through unscheduled rate cases.(16)

This is the first occasion since passage of the Restructuring Act that allows the Department to explicitly state that fuel costs should continue to be treated differently in standard offer rate evaluations. The question was not raised since fuel costs have been relatively stable from 1997 to 1999. Now we are faced with a situation where fuel costs have increased rapidly over a relatively short period of time, so we are required to make explicit what has been implicit in the past. Pursuant to the Act, distribution companies in Massachusetts are no longer directly in the business of power generation, but they are required to procure power for their customers who do not choose a competitive supplier of power. Therefore, the necessity of separately accounting for substantial and rapid changes in the price of fuel has not changed from the pre-restructuring regulatory environment. The only change has been in the mechanism used to account for these changes in the cost of fuel: we no longer conduct § 94G quarterly fuel charge proceedings and so, in order to include extraordinary costs for fuel, operation of the fuel trigger has to be included in the annual adjustments to prices for standard offer service.[(17)] The Department has sought to ensure that prices for generation -- the only competitive portion of customers' electricity service -- reflect the *full* costs of the service, in order to promote competition. See e.g. Fitchburg Gas and Electric Light Company, D.T.E. 97-115/98-120, at 30 (1999); Western Massachusetts Electric Company, D.T.E. 97-120, at 190 (1999). For these reasons, we find that the Act's requirement for a 15 percent rate reduction should be viewed as being exclusive of substantial changes in the cost of fuel.[(18)] Therefore, we find that the proposals of MECo and Fitchburg to treat the SOSFA as a cost to be added as a surcharge outside of the inflation adjustment are consistent with both the Act and the Department's traditional treatment of fuel costs.

As noted, NSTAR has proposed that the increase in the cost of fuel be accounted for as a component of the Act's allowed inflation adjustment. In the past, the Department has found that the Act's inflation adjustment should be interpreted in terms of prices paid by customers, i.e., the consumer price index ("CPI").[(19)] In other words, the Department has maintained that the Act requires that prices for standard offer service paid by customers must be 15 percent lower than they were in August 1997 in terms of *real* (i.e., inflation-adjusted) dollar value of those prices, instead of the absolute value. In effect, NSTAR is asking the Department to interpret the Act's inflation adjustment in terms of supplier costs, i.e., the rate of change for the costs to supply electricity. Such an interpretation, while reasonable, varies from the Department's traditional treatment of fuel cost adjustments, and as such, the Department declines to adopt this proposed method of calculation. The method proposed by MECo and Fitchburg is consistent with traditional fuel cost adjustments and the Restructuring Act. Therefore, substantial changes in fuel costs will be accounted as proposed by MECo and Fitchburg. Moreover, having found the method proposed by MECo and Fitchburg to be more consistent with the traditional approach to fuel cost recovery, the Department finds a clear benefit in adopting a uniform mechanism. However, the Department will allow these adjustments on a prospective basis. Unrecovered amounts to date must be recovered consistent with the rate reduction requirements of the Act and the Companies' restructuring plans. While it is necessary to increase standard offer service rates to include the costs to serve those customers, it is appropriate to delay implementation of those costs until January 1, 2001, in order to allow customers and competitive suppliers an opportunity to adjust to standard offer service rates that include a fuel adjustment. Therefore, this Order is effective for electric consumption on or after January 1, 2001.

NSTAR and Fitchburg propose to adjust their standard offer service rates for the SOSFA on a monthly basis, while MECo proposes to adjust its rate on an annual basis. In addition, NSTAR and Fitchburg propose to use the most recent historic data, while MECo proposes to use forecasts to adjust their standard offer services rates. Having selected a uniform mechanism, we can see no compelling reason to support such differing approaches to the implementation of SOSFA. As with the adoption of a uniform mechanism, there is clear benefit in the uniform implementation of the SOSFA. We are concerned that monthly fluctuations in the standard offer service rate will have the potential to cause customer confusion and will make it difficult for suppliers to market competitive options. An annual adjustment and reconciliation will be less likely to confuse consumers and is administratively more efficient. With respect to whether to use forecasts or historic data, using historic data avoids the need for the Companies to forecast fuel prices, which will be driven by events beyond their control. For these reasons, the Department directs all Companies to adjust their standard offer service rates on an annual basis as part of their reconciliation filing, using the most recently available twelve months of data to calculate the SOSFA surcharge. However, by July 1, 2001, the Companies shall report to the Department their deferral balances as well as their SOSFA monthly amounts so that the Department can determine if an interim adjustment is necessary in order to avoid burdening consumers with additional obligations caused by deferrals.

II. Offsetting Generating Fuel Costs

Although they acknowledge the need to implement the SOSFA, several commenters question whether the Companies have taken all steps available to mitigate the effect of the proposed rate increases on their customers. These commenters call on the Department to investigate the Companies' mitigation efforts.

Mitigation of costs is an integral component of the Restructuring Act. We note that restructuring-related mitigation efforts by the Companies, including the divestiture of generation assets, the sale of power-purchase agreements, and the securitization of transition costs, have led to well over $1 billion dollars in ratepayer savings since March of 1998. Even so, the Department remains committed to ensuring that all available mitigation efforts to offset rate increases do not flag and that standard offer service be procured as efficiently as possible to hold down future costs. The issue of transition cost mitigation is already investigated as part of the Companies' reconciliation filings with the Department. However, due to the potential for significant fuel-related increases in the standard offer service price, the Department will require the Companies, and WMECo, to file an additional, detailed report of their mitigation efforts that have been undertaken since March 1, 1998, and those that are planned for 2001.

The report shall include a description of the following: 1) the divestiture of non-nuclear generating facilities; 2) the divestiture of nuclear generating facilities; 3) the renegotiation, buyout, or adjustment to contractual commitments for purchased power; 4) the sale of assets unrelated to the provision of transmission or distribution services; and 5) any other steps that have already been taken to mitigate the level of transition costs. Further, the Companies should describe additional steps that may be reasonably taken in order to further mitigate costs, including, but not limited to, securitization of transition costs and any necessary changes to recovery schedules for transition costs. The Companies should also discuss whether the Department can or should consider use of the Ratepayer Parity Trust Fund[(20)] to mitigate the effects of the rate increase. In other words, the Companies and WMECo are directed to undertake a thorough and searching review of options for mitigation and offset and to put everything forward for consideration. Such report must be submitted to the Department no later than January 19, 2001. After review of these reports, the Department will determine what further action is necessary.

III. Conclusion

Any company seeking to make a new or amended standard offer service fuel adjustment filing consistent with the guidelines contained in this letter may do so no later than December 6, 2000. Prompt compliance will be necessary if delays in Department review of revised tariffs are to be avoided and if bills for consumption on or after January 1, 2001, are to be issued in a timely manner. Once compliance filings are approved by the Department, the Companies' shall inform their standard offer service customers of the standard offer service rate by way of a bill insert and also by posting the price on the Companies' Web sites and toll free telephone numbers.

The ultimate goal of the Restructuring Act has been to provide Massachusetts consumers with choice and with relief from paying what, in 1997, were among the highest energy costs in the United States. Had we continued along our prior path, we would still be incurring ever higher costs and would be doing so without any hope of future reduction.

As we enter the competitive era, it is the Department's objective, as required by the Act, to

continue to encourage an efficient, competitive market in order to reach our goal. We believe our actions today further that objective.

Sincerely,

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James Connelly, Chairman

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W. Robert Keating, Commissioner

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Paul B. Vasington, Commissioner

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Eugene J. Sullivan, Jr., Commissioner

Deirdre K. Manning, Commissioner

1. During the seven-year transition period from integrated electric monopolies to competitive electric supply, the Electric Industry Restructuring Act, St. 1997,

c. 164 ("Restructuring Act" or "Act") set up "standard offer service" as a transition mechanism through the implementation of a competitive generation market. Each electric distribution company must offer standard offer service from March 1, 1998, through February 28, 2005.

2. These matters were docketed as D.T.E. 00-66, 00-67 and 00-70, for Fitchburg, MECo and NSTAR respectively. Western Massachusetts Electric Company ("WMECo") has not yet petitioned the Department for an increase to its standard offer service rate.

3. After initial review of the filings, the Department issued discovery and held technical conferences on September 25, 26, and 27, 2000, to inquire into each of the Companies' filings. The Attorney General of the Commonwealth of Massachusetts ("Attorney General"), the Commonwealth of Massachusetts Division of Energy Resources ("DOER"), the Associated Industries of Massachusetts ("AIM"), and other interested parties participated in this phase of the investigation. On September 29, 2000, the Department issued a letter directing the Companies to continue to charge their customers at existing rates until our investigation is complete. Standard Offer Service Fuel Adjustments, D.T.E. 00-66, 00-67, 00-70, at 1, Department Order to the Companies (September 29, 2000). The Department solicited two rounds of comments on the Companies' proposals. Initial comments were received on October 10, 2000, and reply comments were received on October 16, 2000. The investigation continued with a public hearing held on November 16, 2000, to receive additional comments on the Companies' requests to increase standard offer service rates as well as on any available mechanisms and options to offset the requested increases. The public hearing record remained open until November 20, 2000, to permit the filing of responses to questions raised during the hearing, to allow for follow-up comments by the participants at the hearing, and to permit any interested person to file additional comments. A final set of information requests was

issued by the Department on November 20, 2000. The Department has intensively reviewed all information gathered in order to be sure that only increased costs properly claimable under settlements, plans, and tariffs, approved pursuant to the Act, have been presented for allowance and recovery.

4. WMECo projects that it will accrue $60 million in deferrals without an increase to its standard offer service rate.

5. See n.13, below, which compares likely deferrals to the Companies' net incomes.

6. Order Adopting Emergency Regulations, D.T.E. 00-89 (November 30, 2000).

7. The "fuel trigger" is the predetermined value to which the sum of the market natural gas price and market fuel oil price are compared to determine if a SOSFA adjustment is allowed. A SOSFA adjustment is allowed only if the sum of the fuel index values exceeds the fuel trigger point. The fuel trigger mechanism was approved by the Department in the Companies' restructuring plans or settlements and their existing standard offer service tariffs. See n.10, n.11, below.

8. The "Low-Income Customer Group" includes Action, Inc., the Massachusetts Energy Directors Association and the Massachusetts Community Action Program Directors Association, Inc.

9. Included in this group are Essential.com, Inc., Green Mountain Energy Company, New Energy East, LLC, Enron Energy Services, Smartenergy.com, Inc., Exelon Energy, Insite Services, LLC, and Utility.com.

10. Massachusetts Electric Company, D.P.U. 96-25 (1997), Boston Edison Company, D.P.U. 96-23 (1998), Cambridge Electric Light Company and Commonwealth Electric Company, D.T.E. 97-111 (1998), Fitchburg Gas and Electric Light Company, D.T.E. 97-115/98-120 (1999).

11. M.D.T.E. No. 912 (Boston Edison Company), M.D.T.E. No. 658 (Cambridge Electric Light Company), M.D.T.E. No. 405 (Commonwealth Electric Company), M.D.T.E. No. 44 (Fitchburg Gas and Electric Light Company), and M.D.T.E.

No. 981-A (Massachusetts Electric Company).

12. The SOSFA compares the sum of the twelve-month rolling average of fuel oil and natural gas prices to a preset trigger point. If the sum of the fuel index values exceeds the trigger point in a given month, the company makes additional payments to its suppliers in that month. If the sum of the fuel index values is less than or equal to the trigger point in a given month, then no additional payments are made in that month.

13. As of August, 2000, the Companies had accrued standard offer service deferrals of: $10.0 million for Fitchburg, $60.0 million for MECo, and $144.8 million for NSTAR (IR-DTE-1-2, Att. DTE 1-2, at 2, IR-DTE-2A-1, at 1 (D.T.E. 00-66); MECo Filing

at Exh. PTZ-1, p. 3; IR-DTE-1-7 at Exh. BEC-10, at 1, CAM-10, at 1, COM-10, at 1, (D.T.E. 00-70)). The Companies estimate the following cumulative standard offer service deferral levels by the end of 2001 if the SOSFA increase is not implemented: $23.3 million for Fitchburg, $469.6 million for MECo, and $192.4 million for NSTAR (IR-DTE-2A-1, at 1 (D.T.E. 00-66); IR-DTE-2-1, at 1 (D.T.E. 00-67); IR-DTE-3-1, at 2, IR-DTE-1-7, at 1, Exh. BEC-10, at 1, CAM-10, at 1, COM-10, at 1 (D.T.E.

00-70)). These values compare to the Companies' 1999 net income figures of: $5.2 million for Fitchburg, $90.3 million for MECo (including the former Eastern Edison Company), and $165.6 million for NSTAR (Fitchburg, MECo, NSTAR FERC Forms 1, at 117 (2000)). These estimated deferral values through the end of 2001 may be over five times the Companies' net income. It is clear that the financial viability of the Companies could be jeopardized by the continued accrual of these deferrals. This situation could affect the Companies' borrowing ability, bond ratings and their ability to maintain a safe and reliable distribution system.

14. Rates for distribution service, which are regulated by the Department, remain unchanged.

15. All of the contracts display and embody a recognition of the interdependence of markets for various fuels. For example, some of the contracts contain fuel escalator clauses where the fuel index is equal to the monthly weighted average sum of three fuel components: estimated New York Harbor spot price for oil, Tenessee Gas Pipeline Companies' average cost of purchased gas, and average delivered cost of coal. Others, including the SOSFA, use two fuel components: the Henry Hub average cost of purchased gas and the New York Harbor spot price for oil (see e.g. IR-DTE-AG-2, App. 4 (D.T.E. 00-66), IR-DTE-AG-1, at 1 (D.T.E. 00-67), IR-DTE-1-4, at 1 (D.T.E. 00-70)). See *Wall Street Journal* commodity page for fuel component prices.

16. Statutory and regulatory recognition of and accounting for fluctuations in generating-fuel costs have been a feature of public utility law in Massachusetts probably since 1936, (see G.L. c. 164, § 119A, inserted by St. 1936, c. 76, § 1) and certainly since 1974, (see G.L. c. 164, § 94G, inserted by St. 1974, c. 625, § 1). It is a familiar mechanism of long standing. See also G.L. c. 164, § 1D.

17. It is not necessary to explicitly provide for fuel cost adjustments to prices for default service because the Act requires that the prices be set equal to the Companies' procurement costs, with no mandated rate reduction.

18. As noted at p. 10, above, two negotiated settlements served as models of the art of the practicable during the 1997 deliberations over St. 1997, c. 164. The Act itself contemplated and expressly allowed for approval of such pre-enactment plans as

consistent with or substantially compliant with the Act. Approvals of such plans, of their SOSFAs, and of tariffs incident to them are a matter of record. No appeal was taken from those approvals.

19. See Letter to All Distribution Companies Re: 1999 Transition Charge Reconciliation Filings, December 17, 1999.

20. G.L. c. 10, § 62.